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TO RUEHC/SECSTATE WASHDC PRIORITY 7148
INFO RUEHRG/AMCONSUL RECIFE 5750
RUEHRI/AMCONSUL RIO DE JANEIRO 3220
RUEHSO/AMCONSUL SAO PAULO 8479
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RHEHNSC/NSC WASHDC
RUCPDO/USDOC WASHDC
RUEHBU/AMEMBASSY BUENOS AIRES 4379
RUEHCV/AMEMBASSY CARACAS 3484
RUEHLP/AMEMBASSY LA PAZ 4956
RUEHAC/AMEMBASSY ASUNCION 5756
RUEHMN/AMEMBASSY MONTEVIDEO 6565
RUEHSG/AMEMBASSY SANTIAGO 5895
RUEHQT/AMEMBASSY QUITO 2016
RUEHPE/AMEMBASSY LIMA 3224
RUEHBO/AMEMBASSY BOGOTA 3983

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SUBJECT: BRAZIL: LULA REAFFIRMS MACROECONOMIC POLICY CONTINUITY

REF: A) BRASILIA 2277 B) BRASILIA 2246

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¶1. (SBU) Summary: Only a day after winning reelection to a second four year term, President Lula was forced by an outburst from his Institutional Relations Minister and PT party stalwart, Tarso Genro, into reaffirming during a series of October 30 television interviews his commitment to his current macroeconomic policies and denying that he would immediately be replacing Finance Minister Guido Mantega and Central Bank Chairman Henrique Meirelles. Many analysts attributed the 1% fall in the Sao Paulo stock index and the 0.6% depreciation of the real on October 30 to Genro's statement that the era of "slow growth" monetary and fiscal policies was over. While Lula's reaffirmation of his commitment to these policies is welcome, he did not/not state that Mantega would be still be on the job on January 1, the date of his second inauguration. The incident is a harbinger of the jockeying to come between political factions within and without the PT over the make-up of Lula's second-term cabinet, much of which will depend on the outcome of negotiations to bring the PMDB into Lula's governing coalition. End Summary.

¶2. (U) Fresh from his October 29 victory in the polls over PSDB presidential candidate Geraldo Alckmin, Lula was forced to use a series of television interviews the following day to walk back statements by his own institutional relations minister, Tarso Genro, who had crowed that Lula's second term meant the "end of the Palocci era" with its emphasis on "slow growth" monetary and fiscal policies. Genro also had stated that Mantega and Meirelles would be leaving immediately. Many analysts blamed Genro's comments for the 1.09 percent drop in the Sao Paulo stock exchange's main index and the 0.6 percent depreciation of the real October 30.

¶3. (U) Lula stated in each of several interviews that there would be continuity in macroeconomic policy. He specifically reaffirmed the GoB's commitment to its inflation-targeting monetary policy

framework. Lula dismissed the idea that Mantega and Meirelles would be out immediately. They serve at the president's pleasure, Lula said, and will remain in their jobs until I decide otherwise. When pressed, he clarified that he has not made any decisions about the makeup of his second-term cabinet. Lula's chief of staff, Dilma Rousseff (comment: who is widely expected to stay on) also told the press that there would be economic policy continuity.

¶4. (U) Genro's comments came in the wake of a statement from Mantega himself in the week preceding the election that Lula's second term economic policy would be more "developmentalist" than the first. Mantega, whose comment was made while out campaigning for Lula, did not elaborate on what precisely that would mean in terms of policy initiatives. Within Brazilian economic circles, the term is generally understood to mean greater government intervention in the economy to promote industrial development.

¶5. (SBU) Comment: The Genro incident is but a small foretaste of the jockeying that is to come over the next two months as political factions try to position themselves for positions of influence in Lula's second-term cabinet, some perhaps with the hopes of a pushing for alternate policies. How the cabinet politics will play out depends in largest part on the negotiations to bring the PMDB into Lula's governing coalition, as the centrist swing party will be seeking some major ministries and policy influence. While there is almost no chance Lula would give the Finance Ministry to the PMDB, neither is it a foregone conclusion that Mantega will remain. Earlier rumors had been floated that Petrobras President Jose Sergio Gabrielli and Belo Horizonte Mayor Jose Pimentel (both prominent PT figures) were the leading candidates to replace Mantega. For his part, Mantega does not act like he will soon depart office. Recently, he replaced his well-regarded International Relations

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Secretary (a holdover from his predecessor's team) with one of his

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own confidantes.

¶6. (SBU) Within the context of this political jockeying, Lula's reaffirmation of his commitment to the current sound macroeconomic policy mix is welcome, as it places some boundaries on the process. The bigger question, however, has always been whether Lula will be able successfully to pursue the mix of microeconomic and structural reforms necessary to improve productivity growth and sustain higher GDP growth rates. That, in turn, will depend on multiple interlocking factors, including the strength and discipline of his congressional coalition and his success in lowering the temperature in the domestic political arena, superheated by corruption scandals and the electoral tribunal's investigations into PT's electoral dirty tricks. Lula's initial extension of an olive branch to the opposition (ref A) is a useful first step.

SOBEL